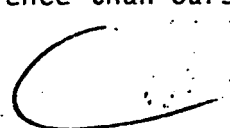


1 July 1982

MEMORANDUM FOR: Deputy Director for Intelligence
FROM: Director of Central Intelligence
SUBJECT: PFIAB Meeting - 8 July 1982

For the PFIAB meeting I would like to be updated on the two estimate judgments which seem to raise the most questions, namely, the level of Soviet military expenditures and Soviet oil prospects. I have your paper of 28 June and concur in the idea of postponing the Community estimate of the Soviet oil prospects until the first quarter of 1983. Meanwhile, I would like to get a comparison of the prevailing estimates, ours, DIA's and the key private estimates circulated. On that score I would like to know the result of briefing of and consultation with Senator Schmitt in response to his offer to provide Soviet oil estimates which he claims have been closer to actual experience than ours.



William J. Casey

Orig C1 by 0008074
Rvw 1 July 1988

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1 July 1982

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

VIA: Deputy Director for Intelligence

FROM: [REDACTED] 25X1

SUBJECT: PFIAB Meeting - 8 July 1982

REFERENCE: Your 1 July 1982 Memo, Same Subject

1. Action. No action required - for your information.
2. SOVA's latest estimates of Soviet defense expenditures are documented in the three attached papers:
 - a. The Soviet defense spending burden estimated in rubles is examined in the November, 1981 paper, "Soviet Spending for Defense: Trends Since 1951 and Prospects for the 1980s".
 - b. Soviet & US expenditure levels and patterns are compared in dollar terms in the October 1981 paper, "A Comparison of Soviet and US Defense Activities, 1971-80".
 - c. Soviet & US expenditure levels and patterns are further compared in ruble terms in the April 1982 article, "A Ruble Cost Comparison of US & Soviet Defense Activities."

Attachments:
As Stated

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Distribution:

Orig. Addressee w/atts

- 1 - DDCI w/o atts
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SO



(1 July 1982)

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A Ruble Cost Comparison of US and Soviet Defense Activities (U)

Comparison of US and Soviet defense activities when both are measured in rubles shows that the Soviet total exceeded US outlays by 30 percent in 1979, whereas the difference is 50 percent when the measurement is made in dollar terms. Thus, whatever the currency used to measure defense activities, the Soviet resource commitment to defense is substantially larger than that of the United States [redacted]

The Index-Number Problem

Because dollars are the natural basis for discussion by US policymakers, CIA comparisons of the overall size of the Soviet and US defense activities have traditionally been made in dollar terms. The Agency derives its estimates of the dollar costs of Soviet defense activities by applying US prices to detailed estimates of Soviet military activities. To state one country's activities in terms of another country's currency will exaggerate somewhat the size of the first country's effort. This phenomenon—called the “index-number problem”—has been the basis of some criticism of CIA attempts to compare Soviet and US defense costs [redacted]

The index-number problem refers to the inevitable difficulty in comparing economic activity in any two countries. To make such a comparison, the activities must be measured in common terms—specifically, they must be stated in a single currency. Since either currency can legitimately be used, the comparison can be done in two ways—which lead to different results. The essence of the index-number problem is that no unique result is possible in such an economic comparison among countries [redacted]

The prospects for making meaningful economic comparisons are not quite as bleak as this might suggest, however. The direction of the index-number bias in any single comparison is easy to identify, and the two complementary comparisons provide a logical range within which a meaningful difference lies [redacted]

The direction of bias is associated with differences in relative resource costs. In producing any collection of goods and services, such as defense, a country tends to use more of resources that are relatively cheap and less of those that are relatively expensive. The choice will differ in another country with a different resource endowment.¹ If the defense activities of a country with abundant supplies of cheap labor are priced in the currency of another country where labor is more scarce and expensive, that pricing will overstate the manpower resources devoted to the first country's defense establishment. If the defense activities of a country with relatively limited and expensive supplies of capital goods are priced in the currency of another country where capital is relatively abundant and less expensive, the pricing will understate the hardware resources devoted to the first country's defense establishment. Leaders of the first country, with cheap labor and expensive capital, will naturally choose a mix of defense resources that emphasizes manpower, and the result of using the second country's currency in a comparison is to exaggerate the size of the first one's defense costs [redacted] 25X1

As a result of differences in resource endowments, dollar comparisons of US and Soviet defense activities tend to inflate the size of Soviet costs relative to those of the United States. Manpower is relatively expensive in the United States, and the relatively high dollar wages somewhat exaggerate the size of Soviet defense activities, which are more manpower-intensive than those of the United States. Of course, comparisons can also be made in ruble terms, using Soviet price and wage data to cost US defense activities. Such ruble comparisons inherently exaggerate the level of US activities relative to the Soviet level—the reverse of the distortion that occurs in dollar comparisons [redacted] 25X1

¹ A country may be more spendthrift (pay less attention to relative resource costs) in defense than in other sectors. (U) 25X1

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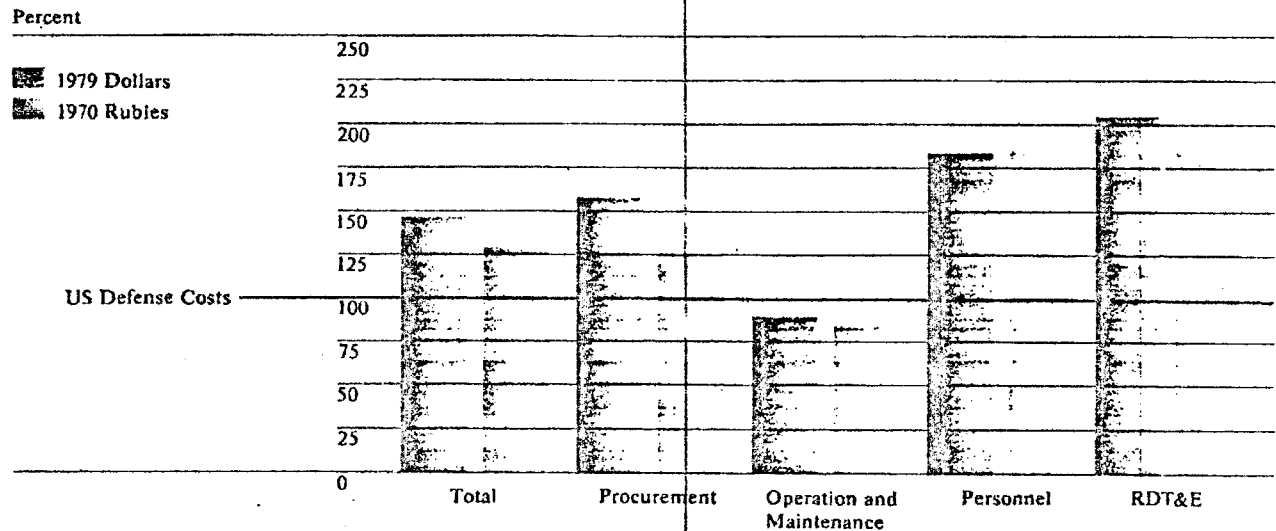
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Soviet Defense Costs as a Percent of US Defense Costs in 1979



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ranging from general to private. The manpower in each rank was multiplied by appropriate ruble rates of pay and ruble allowances for clothing, food, and medical care. Guards and reserves were turned into full-time equivalents based on the hours of paid drill and then multiplied by the average rates of pay for Soviet officers or enlisted men (we have no detailed rank structure for US reserve force).

Ruble Cost Comparisons

Whether measured in dollars or in rubles, Soviet defense costs exceeded US spending by a considerable margin in the late 1970s (see graph). Total Soviet defense costs in rubles were 30 percent greater than those of the United States in 1979; measured in dollars they were 50 percent greater. That is, the Soviet "lead" in total defense costs measured in dollars is 1.15 times the lead measured in rubles.⁴ This spread between the ruble and the dollar comparisons for defense is much narrower than similar calculations for other sectors of the economies of the two countries.

⁴ This 1.15 is derived by dividing 1.5 by 1.3. (u)

For instance, in the case of production of consumer durables, the US advantage measured in rubles is almost twice the US advantage measured in dollars.¹

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The spread between costs measured in rubles and dollars is narrower for defense than for consumer durables because of the relatively greater degree of similarity between the mix of defense outlays for the two countries. In particular, the two armed forces operate with similar equipment-manpower ratios. The USSR has much more manpower, but it also acquires much more equipment each year than the United States does. The basic similarity in structure of the two forces is dictated more by military considerations—they are preparing to confront each other—than by economic considerations. With such a basic similarity, relative defense costs measured in dollars will differ little from those measured in rubles.

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¹ Franklyn Holzman, *International Security Review*, Spring 1980, p. 89. (u)

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